Financial Markets

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Irving Trust

Irving Trust Company
One Wall Street
New York, NY 10015

Economic Research &
Planning Division

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The past week has brought a flurry of economic data that has upset the financial markets. The stock market has fallen rather sharply; the dollar has weakened, principally against the German mark; bond prices have remained severely depressed; and short-term money market rates have been gradually and steadily rising. What common themes exist in the recent releases that would explain such widespread anxiety?

First, if not foremost, has been the effect of Mr. Volcker's testimony before the Senate and House Banking Committees, coupled with his release of revised monetary statistics for 1983 and 1984. Mr. Volcker's testimony dwelt upon the risks facing policy decisions: the budget deficit; the current account deficit; and the potential for inflation to be reignited. Rather than being reassured about Mr. Volcker's resolve to deal with the situation, the markets picked up the theme of problems. The interest sensitive markets were substantially upset by the revision of the monetary data for 1983.

Prior to revision, the growth in M1 had been quite weak; M2 had been below the midpoint of its range; and M3 had just fallen within its target. With the revision, M1's growth was increased overall, with much of it coming at the end of the year. M3 was revised to include Eurodollars: Now the Fed has missed its M3 target in 1983. M2 was not as substantially affected. These revisions took a certain safety net away from the market. The state of the economy was still unclear. But with M1 and M2 growth no longer looking weak, the Fed was not restrained from bringing interest rates higher--suddenly the markets felt a new sense of risk.

The economic news has not brought any solace to the interest sensitive sectors. Part of the strong performance in January is the result of weather problems that had artificially depressed December's data. But even taking the two months together, the economy looks strong, perhaps too strong for this point in the recovery. The strength is not exactly where we would like to see it. There was a gigantic increase--$6.6 billion--in consumer debt in December. Retail sales in January soared from depressed December levels, up 2.2%, while industrial production increased 1.1%. Consumers were taking goods off the shelves at a faster rate than they could be produced. Despite high interest rates, housing starts surged 15% to an annual rate of 1.92 million starts; permits were up sharply too.

The rise in consumer credit underscores current concerns about credit growth and portends a continued dependence on imports, as many consumer goods are made abroad. While production is strong, it is not keeping up with demand. Inventory/sales ratios are low, tending to reinforce future production increases, possibly pressuring capacity further--and again focusing attention on imports to fill the gap. The decline in the dollar may help to solve this problem but certainly not soon. If the dollar's slide broadens, it raises the specter of inflation and still higher interest rates. For now, U.S. interest rates still seem high. Although they haven't slowed the growth of money or consumer expenditures, there must be some concern. The cost of capital is high; the foreign economic recoveries are young and fragile. While many factors point to the potential for higher rates, there is some rationale for temperance.

Robert A. Brusca

Irving Trust

Market Yields

	2/17/84 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.00%	11.00%
Effective since	8/8/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	8.50
Federal Funds	9.50	9.44	8.38
Repurchase Agreements	9.35	9.30	8.38
U.S. Treasury Issues			
Bills			
3 months	9.46	9.37	8.20
6 months	9.86	9.67	8.55
1 year	10.17	9.87	8.80
Coupons			
2 years	10.84	10.69	9.55
4 years	11.36	11.25	9.95
7 years	11.75	11.67	10.30
10 years	11.87	11.77	10.50
Long Bond	11.98	11.90	10.90
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.52	9.45	8.35
3 months	9.75	9.50	8.45
6 months	9.85	9.70	8.65
1 year	10.35	9.95	9.15
Banker's Acceptances			
1 month	9.55	9.55	8.35
3 months	9.70	9.70	8.40
6 months	9.94	9.65	8.60
Eurodollar Deposits			
1 month	9.88	9.75	8.88
2 months	10.00	9.88	9.00
3 months	10.13	9.94	9.13
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.55	9.45	8.38
1 month	9.61	9.55	8.42
3 months	9.60	9.60	8.54
Bank Holding Companies			
1 month	8.94	8.94	7.40
Dealer Placed:			
3 months	9.76	9.71	8.28
New AA Corporate Utility Bond	13.05	13.10	12.20
Tax Exempt			
6 month Project Notes	5.15	5.15	4.20
1 year AAA Bond	5.50	5.25	4.80
5 year AAA Bond	7.00	6.75	6.30
20 year AAA Bond	9.00	9.00	8.90

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

Cable Address:
"IrvingBank" Telex: I.T.T. 420268 • R.C.A. 232241
W.U.I. 62832 • French 82629